was the only means of distributing multichannel video services. Consequently, the Act was designed with that fact in mind.

The stated purpose of the 1984 Cable Act was "to assure that the widest possible diversity of information sources are made available to the public from cable systems in a manner consistent with growth and development of cable systems." 40/ As one means of promoting this goal, Congress established the structure for commercial leased access in Section 612 of the 1984 Cable Act by designating broad parameters for persons unaffiliated with cable operators to demand access to a certain percentage of operators' channels. 41/ Cable operators were prohibited from exercising editorial control over video programming on these channels, although operators could make use of otherwise vacant channel capacity designated for leased access. 42/ As a further means of promoting cable expansion, the statute also directed cable operators to set "the price, terms, and conditions of such use which are at least sufficient to assure that such use will not adversely affect the operation, financial condition, or market development of the cable system." 43/

The legislative history of the 1984 Cable Act reflects a congressional interest in advancing the subscribers' interests through source diversity, and protecting

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40/ Communications Act, § 612(a), 47 U.S.C. § 532(a).

41/ Communications Act, § 612(b), 47 U.S.C. § 532(b).

42/ Communications Act, §§ 612(b)(4). 612(c)(2), 47 U.S.C. §§ 532(b)(4), 532(c)(4).

43/ Communications Act, § 612(c)(2), 47 U.S.C. § 532(c)(1).

the well-being of cable operators and programmers. The House Report indicated that the leased access provisions furthered a goal of the First Amendment, which, according to the Supreme Court, "is to foster 'the widest possible dissemination of information from diverse and antagonistic sources.'" 44/ In particular, Section 612 was supposed to counter a cable operator's incentive to keep opposing social or political viewpoints off the system, or to block competing program services. 45/

Additionally, the House Report recognized that, to the detriment of cable operators, leased access programmers might unjustly benefit from rates lower than those of competing non-leased access programmers. 46/ To eliminate this perceived danger, the statute established a presumption of reasonableness of rates established by the cable operator on the theory that market negotiations should yield fair rates. The House Report noted that: "[t]he Committee does not intend to adversely affect the cable operator's economic position, since it is not the cable operator's exercise of any economic power, but his exercise of editorial control, which is of concern to the Committee."47/

44/ 1984 House Report at 31 (citing *Associated Press v. United States*, 326 U.S. 1, 120 (1945)).

45/ *Id.* at 48.

46/ "Concerns have been raised that if a competing program service could obtain access to the cable system under a scheme that mandated access for a level of compensation beneath that being paid by a similar, existing service, the leased access programmer could unfairly drain audience away from the existing service, and thereby diminish revenue to the cable operator." *Id.* at 50.

47/ *Id.*

The legislative history made clear that Congress did not intend to convert cable operators into common carriers, 48/ nor did it intend that leased access rates be tied simply to the cost of providing capacity. 49/ As noted above, there was no intention that cable operators delete existing services in order to provide capacity for leased access. 50/ Rather, it was anticipated that leased access would be provided as excess capacity became available.

The 1992 Cable Act modified the purpose of the leased access provision to include the promotion of "competition in the delivery of diverse sources of video programming," but it did not change the essential premise that statutory goals were to be accomplished "in a manner consistent with growth and development of cable systems" 51/ and without disruption of cable program services. Among other changes, the 1992 Cable Act authorized the Commission to establish *maximum* reasonable rates for leased access. 52/ Without making additional findings beyond a contemporaneous FCC Cable Report, the House Committee indicated a concern "that cable operators

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48/ *Id.* at 51 ("nothing in these provisions is intended to impose a requirement on a cable operator that he make available on a non-discriminatory basis, channel capacity set aside for commercial use by unaffiliated persons").

49/ *Id.* at 52 ("in establishing a reasonable price pursuant to this section, a cable operator is not limited to simply recovering his costs and potential losses of revenue diverted from other services").

50/ *Id.* at 49.

51/ 1992 Cable Act, § 9(a) (codified at 47 U.S.C. § 53(a)).

52/ Communications Act, § 612(c)(4)(A)(i), 47 U.S.C. § 532(c)(4)(A)(i).

have financial incentives to refuse leased access channel capacity to programmers whose services may compete with services already carried on the cable system, especially when the cable operator has a financial interest in the programming services it carries." 53/

The establishment of maximum reasonable rates was designed to be a ceiling for rate negotiation and to provide a safety valve to increase certainty in bargaining for leased access agreements and the use of leased access channels. 54/ Dissenting members of the Senate Committee objected to the prospect that leased access rules could result in intrusive and unnecessary government regulation that could reduce programming diversity. 55/

Given this legislative background, in 1993 the Commission designed initial leased access rules to avoid concerns that leased access would harm programming or consumer choice. By permitting cable operators to recover up to the *highest* amount they received from unaffiliated programmers in a given category, the Commission's

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53/ COMMITTEE ON ENERGY AND COMMERCE, CABLE TELEVISION CONSUMER PROTECTION AND COMPETITION ACT OF 1992, H.R. REP. NO. 628, 102d Cong., 2d Sess. (1992) at 39.

54/ SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION, CABLE TELEVISION CONSUMER PROTECTION ACT OF 1991, S. REP. NO. 92, 102d Cong., 1st Sess. at 32 (1991) ("The operator and programmer can bargain for a lower rate.")

55/ The dissenters wrote that "[w]e are deeply concerned that the net, albeit unintended, effect of many of the [Senate bill's] provisions -- including rate reregulation and program access -- would be to curtail greater investment in increased channel capacity, new technologies, and programming." Minority Views, SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION, CABLE TELEVISION CONSUMER PROTECTION ACT OF 1991, S. REP. NO. 92, 102d Cong., 1st Sess. at 97 (1991).

highest implicit fee rate methodology did not penalize cable operators for carrying leased access channels. In an attempt to balance its statutory obligations, the FCC established a rate to "enable commercial leased access to become [a] source of programming diversity," but that would "not adversely affect the operation, financial condition or market development of" cable systems. 56/ The Commission expressly rejected a cost-of-service option proposed in the original NPRM because of the possibility that "substantial migration will occur with uncertain and possibly harmful effects on the structure of the industry." 57/

When viewed against this policy background, the Commission's current leased access formula proposal represents a complete departure from the Commission's historic understanding that its regulatory approach must not disrupt the industry. It is inconsistent both in terms of how a "reasonable" rate is to be calculated, and in its treatment of incumbent cable services. The Commission acknowledges that its proposed new rate formula is "a significant departure" from its previous approach. 58/ But the difference is more fundamental than simply the consideration of a new pricing formula. The FCC's proposal represents a complete reordering of the public interest values continuously embraced by both Congress and the Commission. This inconsistency must be remedied.

56/ *Rate Order* at ¶ 515 (citation omitted).

57/ *Id.* at ¶ 513.

58/ *NPRM* at ¶ 32.

B. The Commission's Experience With Cable Rate Regulation Demonstrated that the Public Interest Requires Reasonable Incentives for Programming Services

When the FCC initially adopted rate regulations pursuant to the 1992 Cable Act, it failed to incorporate provisions that would encourage operators to add new channels to their systems. In fact, under the FCC's initial rate regulations, the only vehicle for operators to recover costs of adding new channels was the unwieldy cost-of-service methodology, which was unavailable to many operators because of the structure of the cost-of-service rules. The rules had created an artificial bottleneck that was stalling new launches and stifling existing services. When the Commission became aware of this problem, it took remedial action.

Specifically, the FCC developed "going-forward" rules to provide incentives for cable operators to add channels to their systems. 59/ Citing its concern that then-current rules "may not provide sufficient incentives for systems with more than 12 current channels to add new channels," the FCC revised its rules "[b]ecause appropriate incentives for adding new channels serves the statutory goal of 'promot[ing] the availability to the public of a diversity of views and information.'" 60/ The revised

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59/ Congress recognized in the 1996 Telecommunications Act that rate regulation had unintended consequences, and put the FCC on a track toward deregulation. The FCC's 1992 Act rulemaking proceedings on rate regulation and other issues are relevant here because they indicate the FCC's understanding that the public interest includes promotion of programming services.

60/ *Rate Regulation, Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking*, 10 FCC Rcd 1226 at ¶ 8 (1995).

"going-forward" rules, which permit a 20-cent mark-up for up to six new channels added to the CPS tier as well as a pass-through of up to 30 cents for license fees, were designed to "benefit consumers by assuring that operators will have incentives to add new services . . . ." 61/

Also as part of the "going forward" rules, the Commission created "new product tiers" ("NPTs"), tiers consisting exclusively of new services (and duplicative services already carried on other tiers). NPTs were designed to "provide additional incentives for operators to provide new services to consumers because operators will be permitted to price these tiers as they choose." 62/ When the FCC created NPTs, it acknowledged the shortage of channel capacity for new services. According to the FCC, the NPTs would "create additional capacity for new services on CPSTs. This capacity should help create opportunities for programmers to establish an audience for their new channels." 63/

The FCC also adopted special rate regulations for small operators to encourage the addition of channels. Specifically, small system operators were permitted to use a streamlined cost-of-service methodology to justify rate increases based on channel additions. 64/

61/ *Id.* at ¶ 64.

62/ *Id.* at ¶ 22.

63/ *Id.* at ¶ 32.

64/ *Id.* at ¶¶ 87-94.

In addition to modifying the "going forward" rules to coincide with the goal of promoting diversity, the FCC issued a number of declaratory rulings and waivers crafted to facilitate launches of new services. For example, the FCC waived the rules to permit cable operators to pass through immediately the launch costs for the new service fX, where the rules would have otherwise required a waiting period before those costs could have been recovered by cable operators. 65/

In another move to relieve some of the tension between programmers seeking to be added to cable systems and cable operators that were constrained by rate regulation, the FCC developed the concept of flexible "social contracts." The FCC has entered into social contracts with a number of cable operators for the purpose of resolving rate complaints. Although the social contracts generally cap rates that may be charged by operators for all tiers of service, many of the social contracts provide for the creation of "migrated product tiers." 66/ The FCC created NPTs and MPTs "to expand the programming choices available for subscribers." 67/ The FCC was willing

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65/ *Letter to Robert Corn-Revere from Alexandra M. Wilson* dated April 19, 1994. In another ruling, the FCC determined that marketing expenses for which cable operators were reimbursed by a programmer did not have to be offset against increases in programming costs for calculation of external cost pass-throughs. *Letter to Frederick Kuperberg from Kathleen M. H. Wallman*, 9 FCC Rcd 7762 (May 23, 1994). The FCC also relaxed notice requirements to facilitate new launches. *See, e.g.*, *Letter to Michael Ruger from Meredith J. Jones*, 10 FCC Rcd 3207 (February 10, 1995).

66/ *See, e.g., Cox Communications, Inc. Social Contract*, FCC 95-483 at ¶ 35 (Dec. 1, 1995).

67/ *Id.* Migrated product tiers permit operators more flexibility than "new product tiers" because programming services may be moved from a regulated tier to a migrated

[Footnote continued]

to offer operators the flexibility to combine established anchor programmers with new programmers to create a more attractive package, and to apply a relaxed level of rate regulation to these packages, again demonstrating a commitment to fostering diversity on the part of the FCC.

C. The Commission Should Focus on Congressional Objectives in Implementing Statutory Requirements

Although the Commission denies any intent to "subsidize" leased access programming and states that it is not seeking to "guarantee that leased access programming will increase," 68/ the overall thrust of the Commission's proposal would do both. 69/ Indeed, the Commission is proposing "a significant departure" from current rules in order to develop what it describes as "an economically sound mechanism" to determine "the appropriate level of leased access demand." 70/ In this regard, it condemns the highest implicit fee formula for "overcompensat[ing] cable operators" and for "not sufficiently promot[ing] the goals underlying the leased access provisions." 71/ The Commission tentatively concludes "that the maximum rate for leased access

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[Footnote continued]

product tier. New product tiers, on the other hand, consist only of new services and services carried duplicatively from other tiers.

68/ *NPRM* at ¶ 68.

69/ *Id.* at ¶¶ 27-28.

70/ *Id.* at ¶ 63.

71/ *Id.* at ¶ 29.

should depend on whether the cable operator is leasing its full statutory set-aside requirement." 72/

The Commission's disclaimers notwithstanding, its proposal is focused almost exclusively on filling a leased access quota. 73/ In doing so, the Commission has almost entirely lost sight of the original congressional objectives. While the FCC claims to be "balancing the needs of programmers with the needs of cable operators," 74/ it appears to have forgotten those programmers that are providing the public interest benefits described earlier.

In implementing Section 612, the Commission should not substitute statutory *mechanisms* for statutory *objectives*. If nothing else, the unsuccessful attempt to jump-start video competition through the regulatory construct of video dial tone should provide a lesson. The regulatory mechanism in that example ultimately did not advance the public interest objective of increasing video competition. Accordingly, Congress and the Commission ultimately abandoned video dial tone and found other means of pursuing the objective. The "social contracts" that resolved rate regulation disputes provide a further example of meeting statutory objectives by not imposing statutory mandates. The Commission concluded that it "may conduct its proceedings in

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72/ *Id.* at ¶ 65.

73/ *Id.* at ¶ 72. ("Congress has defined the appropriate level of output by establishing the set-aside requirement, and the operator cannot restrict the output below this level").

74/ *Id.* at ¶ 26.

such a manner as will best conduce to the proper dispatch of business and to the ends of justice. . . ." 75/ The Commission found that its goals to "simplify" regulation and "afford adequate protection for subscribers [and others]" were served by a flexible approach, rather than by strict application of the rules. 76/ By the same token, the FCC clearly is not required to adopt a quota-based leased access regime reflecting a severe statutory interpretation. For the same reasons, the Commission should not consider leased access to be an end in itself. Nothing in the statute or Commission policy requires that it do so.

It is clear that Congress never intended leased access to be imposed as a rigid requirement, divorced from overall statutory objectives. Instead, as the cable industry approaches higher levels of coverage and market penetration, the Commission's perspective should be forward-looking. An unfettered programming marketplace could best respond to the upcoming increases in channel capacity.

IV. THE COMMISSION'S PROPOSED LEASED ACCESS FORMULA WILL REDUCE PROGRAMMING DIVERSITY

The Commission's proposed leased access formula will reduce programming diversity -- exactly the opposite of the effect intended by Congress. The formula creates an unjustifiable subsidy for leased access programmers, thereby

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75/ *Comcast Cable Communications, Inc., Final Resolution of Cable Programming Service Rate Complaints, Order*, FCC 95-482 (Dec. 1, 1995), citing Communications Act § 4(j), 47 U.S.C. § 154(j).

76/ *Id.* at ¶ 13.

creating a quota for such channels. The Commission acknowledges that this will "bump" existing services from cable systems. Indeed, the very services praised so recently by Vice President Gore and Chairman Hundt are at risk of being sacrificed. This substitution is not done in the name of subscriber preferences. Quite to the contrary, quality cable programming services will be lost because of government fiat and in spite of consumer demand.

A. The Proposed Leased Access Formula is a Quota-Based Subsidy

Although it disclaims any intent to "subsidize" leased access programmers, 77/ the proposed formula does just that. As noted above, the Commission assumes that "demand" for leased access channels is defined by the percentage of channels specified in Section 612. Thus, the *NPRM* states that "Congress has defined the appropriate level of output by establishing the set-aside requirement" and that failure to meet this quota reflects the ability of cable operators "to restrict output below the desirable level." 78/ Based on this assumption, the proposal would require operators to charge below-market rates for leased access channels until the quota is filled. 79/

77/ *NPRM* at ¶ 27.

78/ *Id.* at ¶ 72.

79/ *Id.* at ¶¶ 71-72. ("[U]nder our proposal, the operator cannot charge market rates if the number of channels leased falls below the number designated by the statute.")

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This interpretation of leased access requirements is the very definition of a subsidy. 80/ It defines a "reasonable" rate as one calculated to fill the specified number of channels rather than one that operates within the cable programming market or serves the Commission's overall diversity policies. In effect, the formula establishes a quota of channels to be filled.

In a true economic sense, "reasonableness" of rates is not based on affordability of access for favored programmers, but on the value of goods and services exchanged. As the Commission acknowledged in its initial *Rate Order*, "[t]he value of a channel would logically vary significantly based on the subscriber base it accessed. Even within tiers, channels may be perceived to have different values . . ." 81/ In the leased access arena, the FCC assumes that leased access channels are too expensive if programmers are not using all the designated leased access slots. This analysis, which equates affordability with demand, does not take into account that leased access is not a natural "market," but a governmentally created one. Therefore, the FCC's statements concerning "demand," a market-based concept, are misplaced. 82/

80/ *See* Section IV.B.3, *infra*.

81/ *Rate Order* at 5940, n.1282.

82/ *NPRM* at ¶ 71-72 (the FCC defines "market power" based on parity with the governmentally-imposed quota of access channels).

B. The Proposed Formula Does Not Reflect Subscriber Demand or Account for All Costs.

1. Subscriber Preferences Are Ignored

The Commission's proposed formula undercuts the programming market and loses sight of the intended beneficiaries of diversity -- the subscribers. The Commission's proposal assumes that one leased access programmer's willingness to pay more for channel space than another reflects consumer willingness to pay for that programming, and that this mechanism efficiently communicates subscriber preference. 83/ However, the proposal ignores subscriber preferences, because it defines the "desirable" level of "output" by numbers specified in the statute rather than by references to actual demand. The Commission's statement that it "is faced with balancing the needs of *programmers* with the needs of cable operators" is no answer because it does not explain why leased access programmers should be favored over existing cable services. 84/ Moreover, it begs the question of where subscribers fit into the balance.

The FCC's new economic analysis, which includes a bifurcated cost-based/market-based approach, assumes that subscriber demand for leased access programming is equal to subscriber demand (and willingness to pay) for non-leased access channels. Based on this unsupported (and incorrect) assumption, the

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83/ *NPRM* at ¶ 10.

84/ *NPRM* at ¶ 26 (emphasis added).

Commission concluded that cable operators "double-recover" for leased access channels under the highest implicit fee methodology. 85/

Not only does the FCC fail to take into account perceived subscriber value for a given channel, but also the FCC's methodology assumes a uniform value for channels, regardless of channel or tier placement. The formula requires a generic calculation of average subscriber revenues for the entire tier on which the leased access programmer demands carriage. There are no adjustments for carriage on a more desirable (or less desirable) channel. Congress and the FCC have long recognized the value of channel position. Congress was careful to include channel position rights in the must-carry law. 86/ The FCC has recently implicitly confirmed that the value of a channel may vary significantly, depending on tier placement, in the

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85/ Calculation of the highest implicit fee requires a determination of the highest amount paid by subscribers for a channel on a tier. The license fee for the channel is subtracted from the average per channel revenue for channels on the tier. This is the method for determining the highest implicit fee, which, under the FCC's current rules, is the amount charged for a leased access channel. Once the leased access charge has been established, the FCC makes the leap of faith that the leased access charge is equal to the amount that subscribers are willing to pay for the leased access channel. Then, because subscribers are already paying the cable operator the highest implicit fee for the leased access channel, the FCC reasons, the cable operator is "double-recovering" because the leased access programmer also is paying the highest implicit fee for the channel. But in fact, the problem of "double recovery" simply does not exist -- there is no evidence whatsoever that subscribers are willing to pay for the programming offered on a leased access channel. The FCC's concern that operators are "double-recovering" for leased access channels is based on the false assumption that programming is fungible and programming is selected and packaged by cable operators without regard to its perceived value to subscribers.

86/ Communications Act, § 614(b)(6), § 615(g)(5), 47 U.S.C. §§ 534(b)(6), 535(g)(5).

context of new product tiers and migrated product tiers. Indeed, in its *Rate Order* on leased access, the FCC recognized that tier and channel placement have different values. 87/ Considering the FCC's familiarity with channel position and tier placement issues, it is difficult to understand why the Commission did not build into its proposed methodology provisions for varying rates depending on channel and tier placement.

Oddly, the best indicia of "diversity" are expressly excluded from the proposed formula. For example, the Commission concludes that cable operators should not recover costs due to revenue loss arising from decreased subscribership, because the displacement of a valued programming service for a leased access programmer "is too speculative to measure accurately" for a given tier. 88/ While valuing subscribership loss may be difficult, deeming it "speculative" does not make it disappear. Moreover, it is the only true measure of the subscribers' perceptions of diversity and programming value. Additionally, another significant element of the operator's loss -- the lost opportunity to program the channel -- is not even factored into the cost-based formula.

The Commission acknowledges that "dark" channels do "not necessarily indicate a lack of available programming," and that this excess capacity may be valuable to the operator as reserved space for more attractive programming that may become available in the future. Based on this acknowledgment, the FCC proposes to

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87/ *Rate Order* at n.1282.

88/ *NPRM* at ¶ 86.

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permit operators to "assign these dark channels the per channel opportunity cost of the programmed channels on the system with opportunity costs that have the *lowest* positive values . . ." 89/ The notion that an operator preserving an open channel in anticipation of "more desirable" programming is not reconciled with the decision to assign the *lowest* value possible to these channels when calculating a *maximum* rate.

2. The Proposed Formula Would Create Instability For Programming Lineups.

The proposed formula is also extremely disruptive to the ability to maintain stable programming line-ups. The subsidized "cost-based" rate will attract programmers to leased access channels up until the point where the "cost-based" quota channels are filled. At that point under the FCC's bifurcated pricing proposal, market rates may be charged for leased access channels. The FCC's purported goal is for an operator to achieve -- ultimately -- a full complement of leased access channels and a market-based approach to rates. 90/

However, it is difficult to envision a scenario where these objectives would be met. Instead, operators will be forced to enter contracts charging below-market, cost-based rates for leased access channels. When the quota of subsidized channels has been filled, operators will adjust their rates up to the market-based level. The first leased access programming contract to expire will not be renewed (because the leased

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89/ *Id.* at ¶ 87 (emphasis added).

90/ *Id.* at ¶ 10.

access programmer will refuse to pay the higher, market-based rate). When the leased access programmer refuses to renew its contract, the cable system will no longer have a full complement of leased access channels, requiring reversion to the cost-based rate methodology. The leased access programmer that did not renew its contract may then do so at the lower, cost-based rate. 91/

The Commission's proposed rules regarding part-time access also are extremely disruptive. Its conclusion that cable operators should be required to accommodate both full and part-time leased access users in increments of as little as 1/2 hour would seriously interfere with the business practices of existing networks. 92/ For example, the proposed formula requires cable operators to designate channels and states that "the designated channels *must* be the ones that are in fact used to accommodate leased access requests." 93/ Such a requirement can devastate the investment climate, viewership, the advertising market and the ability to acquire programming for existing networks that end up on a cable operator's hit list, even if access ultimately is not required. It provides yet another stark example of how the proposed formula utterly ignores market realities

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91/ The FCC's bifurcated system will not work because the ultimate goal of the system -- to achieve market-based rates -- will never be achieved. There is no mechanism to require that leased access programmers ever make the transition from "cost-based" to market-based rates.

92/ *NPRM* at ¶ 47.

93/ *Id.* at ¶ 100 (emphasis added).

3. The Proposed Cost-Based Method of Setting Leased Access Rates Fails to Include All Costs

When it adopted leased access requirements, Congress was quite clear in stating that the Commission should not adopt a cost-based formula. It noted that "in establishing a reasonable price pursuant to this section, a cable operator is not limited to simply recovering his costs and potential losses of revenue diverted from other services," and that leased access rates should not be "lower than the fair market price" for channel capacity. 94/ Contrary to the legislative history, the Commission is now taking the position that until the leased access quota is met "the rate should be high enough to recover all reasonable costs of leasing and a reasonable profit, but no higher," and that operators may charge a fair market rate for capacity only after "an operator fulfills its set-aside requirement." 95/ Worse still, the proposed formula would not permit cable operators to recover their true costs.

Here, the FCC admits that the proposed "cost-based" formula that would govern rates until a system carries a full complement of leased access channels does "*not* allow the operator to recover all opportunity costs." 96/ The Commission further acknowledges that "the cost formula is not intended to guarantee that all operating

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94/ 1984 House Report at 51, 52.

95/ *NPRM* at ¶ 31, 96. The Commission's proposal to allow cable operators to make a "reasonable" profit from leased access is illusory, since it does not permit them to recover all costs in the first place.

96/ *NPRM* at ¶ 69 (emphasis added). *See also id.* at ¶ 79 ("We recognize that our proposed formula does not incorporate all opportunity costs.")

costs will be fully recovered." 97/ And, the Commission does not propose to allow operators to claim costs based on loss of subscribership due to leased access because it is "too speculative to measure accurately." 98/

There is no reason for the FCC to restrict the costs that may be recovered by cable operators that are forced to replace carefully selected programming services with commercial services that demand carriage under leased access provisions. As discussed above, this plainly contradicts the congressional command that "the price, terms and conditions" of leased access use must be such that they do "not adversely affect the operation, financial condition, or market development of the cable system." 99/

Particularly with the advent of competition from DBS and telephone companies in the multichannel video distribution marketplace, a cost-based formula for leased access that does not permit cable operators to recover all costs will adversely affect the operation, financial condition and market development of the cable system. Development of a fair and workable cost-based methodology is critical here because, as discussed above, it is unlikely that the FCC's market-based formula will ever be used under the bifurcated procedures.

97/ *Id.* at ¶ 67.

98/ *Id.* at ¶ 86.

99/ Communications Act, § 612(c)(1), 47 U.S.C. § 532(c)(1).

Under a formula that truly reflects costs, the leased access rate could actually increase. The FCC asserts that the cost-based formula is not intended to lower leased access rates and is designed to "allow the operator to continue to recover its operating costs to the same extent it would without leasing, and to recover additional reasonable costs, including a reasonable profit, associated with leased access." 100/ But as set out in the *NPRM*, the formula appears designed *precisely* to lower leased access rates. The cost-based methodology, if properly designed, will yield a rate based on cost and a reasonable profit that may be higher, lower, or equal to the currently prevailing "highest implicit fee" calculation.

C. The Commission's Leased Access Proposal is "Zero Sum" at Best and Will Result in Less True Diversity

The FCC proposes to adopt a pricing methodology that will reduce leased access rates in the name of promoting diversity. However, there is no reason to believe that diversity will benefit from lower leased access rates. The FCC's proposal -- at best -- will displace existing services in favor of an equal number of subsidized leased access programmers.

The "zero sum" nature of the leased access proposal is flatly inconsistent with the Commission's other policies designed to enhance diversity. As discussed above, revised "going forward" rules were instrumental in saving the launches of several new services by permitting cable operators to increase rates when they add

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100/ *NPRM* at ¶ 63.

services. The FCC's flexible approach in other facets of regulation -- such as permitting the creation of NPTs and MPTs, and the streamlined cost-of-service methodology for headend upgrades -- provided incentives to increase capacity and programming services without favoring any group of programmers over another.

The proposed formula will reduce programming diversity. The Commission presumes that diverse non-leased access programmers will be expelled from cable systems under its plan. This is the most troubling aspect of the FCC's proposal. New and creative services -- the heart of diversity in cable programming -- will be on operators' "hit lists," subject to expulsion whenever the next leased access programmer comes along. The Commission states, for example, that "operators generally will want to use their least profitable channels for leased access." 101/ In most cases, this would target the newer, less established channels.

Programming services that are included on operators' "hit lists" will not be popular on Wall Street. Investors will be understandably reluctant to finance a programming service that launches on a cul-de-sac. Because of such concerns, the Commission's proposal can harm existing cable services that are designated to be dropped even if leased access programmers do not materialize. The very fact of being designated can undermine the viability of a network.

The only criterion for carriage under the Commission's proposal is the ability to pay for channel space. Therefore, it is unlikely that the leased access services

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101/ *NPRM* at ¶ 100

that will replace the bumped programmers will offer new, innovative or diverse programming. Indeed, the economic criteria for selection may create a perverse incentive for leased access programming to be of the same genre -- or, in a worst case scenario, 100% duplicated, identical programming. For example, several of the entities that filed comments in the captioned proceeding as potential "leased access programmers" were home shopping services. 102/ It will be ironic if the FCC adopts rules in the name of diversity that result in the displacement of services such as A&E, Ovation, Court TV, CNBC, America's Talking or The History Channel in favor of six newly subsidized shop-at-home services. 103/

The shortage of channel capacity is particularly threatening for new networks, such as Ovation. Ovation is in the process of launching. Many operators have indicated that they are interested in carrying Ovation's programming, but have cited insufficient channel capacity as a problem. For example, Ovation will not be added to the cable system serving New York City, owned by one of Ovation's equity partners, Time Warner, until channel capacity becomes available. 104/

102/ *See NPRM* at Appendix A.

103/ Nor do such services need another guaranteed space on cable systems. The FCC has already ruled that broadcast stations with home shopping formats are entitled to demand carriage on cable systems under "must-carry" rules. *In the Matter of Implementation of Section 4(g) of the Cable Television Consumer Protection and Competition Act of 1992, Home Shopping Station Issues*, 8 FCC Rcd 5321 (1993).

104/ "Curtain Rises for Ovation," *Broadcasting & Cable*, April 22, 1996, p.52.

V. THE FIRST AMENDMENT LIMITS THE COMMISSION'S ABILITY TO CREATE A LEASED ACCESS QUOTA

A. The First Amendment Constrains Any Leased Access Formula That Would Substitute "Favored" Programming for Existing Services

The government's current leased access proposal must be rejected if it does not satisfy First Amendment requirements. Commenters are not arguing in this proceeding that leased access obligations are unconstitutional *per se*. It is unnecessary to reach such a sweeping question in order to analyze the Commission's current proposal. 105/ Rather, for purposes of the instant proceeding it is sufficient to note that important constitutional constraints apply to the leased access formula as currently proposed by the Commission.

When it created public and leased access obligations in the 1984 Cable Act, Congress addressed some of the attendant First Amendment issues. It described the access provisions as "a form of content-neutral structural regulation which will foster the availability of a 'diversity of viewpoints' to the listening audience." 106/ The

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105/ There has been no definitive constitutional challenge to statutory leased access requirements. It is worth noting, however, that the D.C. circuit, sitting *en banc*, recently expressed "no view on whether the provisions of the 1984 and 1992 Acts requiring cable operators to set aside leased access channels . . . infringe upon the First Amendment rights of cable operators or programmers." *Alliance for Community Media v. FCC*, 56 F. 3d 105, 114 note 5 (D.C. Cir. 1995) (*en banc*), *cert. granted sub nom. Denver Area Educational Telecommunications Consortium, Inc. v. FCC*, 116 S. Ct. 471 (1995). *See also Daniels Cablevision, Inc. v. United States*, 835 F. Supp. 1 (D.D.C. 1993) (challenge to access requirements did not examine rules as applied).

106/ 1984 House Report at 31.

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legislative history defended the constitutionality of such measures by comparing them to the limited right of access permitted in the broadcasting context as approved in *Red Lion Broadcasting Co. v. FCC.* 107/ Congress also compared access requirements to the antitrust laws that are designed to foster "a greater diversity of information sources." 108/

These conclusions were never tested in court, and were reached before the First Amendment rights of cable operators were judicially established. Shortly thereafter, the Supreme Court held for the first time that cable operators are protected by the First Amendment. 109/ More recently, in *Turner Broadcasting System, Inc. v. FCC*, 110/ the Court made clear that there "can be no disagreement" that "[c]able programmers and cable operators engage in and transmit speech, and they are entitled to the protection of the speech and press provisions of the First Amendment." 111/

In reaching this conclusion, the Court expressly rejected the First Amendment theories discussed in the 1984 legislative history. It emphasized, for example, that "[i]n light of these fundamental technological differences between

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107/ 395 U.S. 367 (1969).

108/ 1984 House Report at 32.

109/ *City of Los Angeles v. Preferred Communications, Inc.*, 476 U.S. 488, 494 (1986).

110/ 114 S. Ct. 2445 (1994).

111/ *Id.* at 2456 (1994).